

# **COMPETING FOR MARKETS: A FRAMEWORK OF STRATEGIES FOR SMEs**

## **Why the need for a new framework?**

Existing strategy frameworks are designed for bigger firms with plentiful resources. They should not be liberally borrowed and advanced as solutions for SMEs, who face resource constraint. This very lack of resources impacts the competitive strategies that are feasible to SMEs.

Take the niching strategy for example. Although many experts advocate this to be the most suitable strategy for SMEs, it may not be sustainable for a SME. A successful niching strategy often implies that SMEs must target at market segments that are ignored by their bigger rival firms. Some experts claim that the bigger firms' fear of self-cannibalization is one reason why they choose to ignore certain market segments or gaps. That is, the bigger rival firms are concerned that, should they introduce a new product to counter that offered by the SMEs for the market niche, it would cut into sales of their existing range of products.

However, this explanation lacks credibility because the extent of self-cannibalization depends on whether there is sufficient product differentiation in the market niches served. Furthermore, comparing the losses due to self-cannibalization versus the prospects of conceding an entire market segment to a SME, surely it makes more sense for a bigger firm to pre-empt a SME's entry by supplying the market niches before the SME.

In fact, it might even be feasible for a bigger rival to follow a SME's strategy by entering the same market niche and supplying a similar product to that offered by the SME. Furthermore, by using its deep pockets to finance aggressive competitive actions against the SME, the bigger rival would have a better than even chance of grabbing the market niche from the SME. This suggests that SMEs should not follow the niching strategy of supplying differentiated products, unless they can effectively deter entries by bigger rivals.

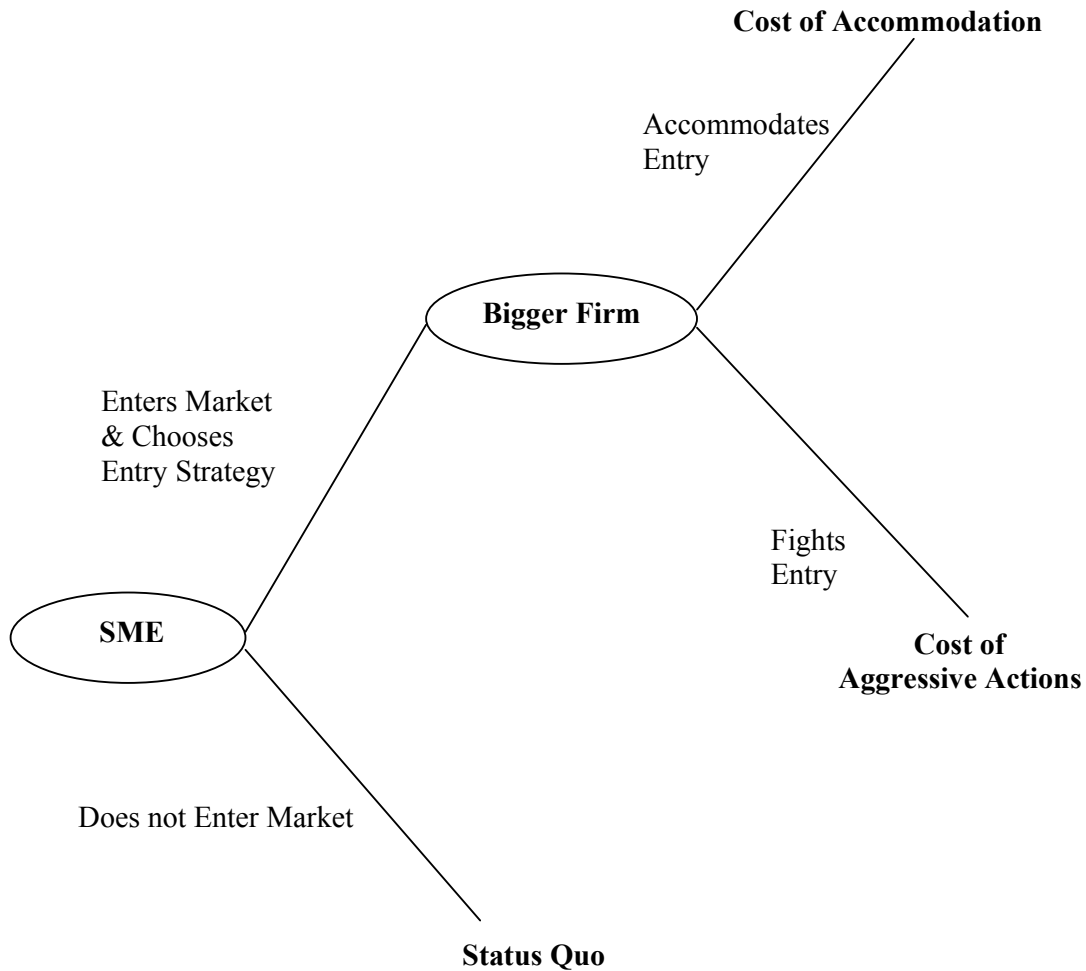
What's more, the current literature in SME strategy fails to take into consideration potential competitive reactions from market incumbents in prescribing competitive strategies for SMEs. By ignoring competitive reactions, the literature therefore has no answers to questions about how bigger incumbent firms will respond when the market niches served by SMEs grow to a substantial size or become very lucrative. Nor does the current literature provide any strategic prescriptions for SMEs as to how they could compete successfully against bigger rivals who possess superior resources.

## **The key to successful market penetration: Forcing the bigger rivals to accommodate**

To answer how bigger incumbent firms might react to entry by an SME into their markets, it is important to understand the competitive interactions between a SME and a bigger incumbent rival, which Figure 1 illustrates. With reference to the figure, the SME has two choices in terms of market entry strategy. It may contemplate entry into a market segment that is currently being ignored or one that is currently being served by the bigger firm.

The success or failure of a SME in entering a targeted market segment depends very much on

how the bigger incumbent firm reacts to its entry. The bigger incumbent firm could either “fight” a SME’s entry. Alternatively, it might, after weighing the costs and benefits, ignore or accommodate the SME’s entry by choosing not to fight aggressively against the SME’s entry. Obviously, it would be the ideal for the SME if the bigger incumbent chooses to accommodate the SME’s market entry. What are there strategies that are available to the SME to achieve this?



**Figure 1:**  
**The Choices Available to the SME and the Possible Reactions from the Bigger Firm**

**Competing against the bigger rivals: Strategies for SMEs**

Figure 2 illustrates the strategy options for a SME in market entry. As the figure shows, SMEs could enter new market segments currently being ignored by bigger rival firms by offering differentiated products/services. This is the traditional and often recommended niching strategy.

Alternatively, SMEs also could target established market segments currently being supplied by bigger rival firms by following a substitution strategy or a free-riding strategy in entering the market (see Figure 2). These strategies are devised for SMEs to force bigger incumbent firms to accommodate the SMEs' market entries.

Successful implementation of the substitution strategy requires that SMEs offer differentiated yet substitutable products to that of the incumbent firms in the market of entry, so as to force accommodation by the latter. Product differentiation can be in the form of better before and after sales services, including warranty services. The substitution strategy can be successfully applied in market entry by SMEs because bigger rivals who are faced with such a strategy would find that aggressive counter actions against the SMEs' entry would be too costly in terms of reduced profits in the other segments that the bigger rivals serve. As the bigger rivals would choose to accommodate the SMEs' market entry, it is thus not essential for SMEs to possess a cost advantage in applying the substitution strategy to compete against the bigger rivals.

**Figure 2:  
Competitive Strategies for SMEs to Successfully Penetrate Markets**

		<b>The Bigger Firm's Reactions</b>		<b>The Bigger Firm</b>	
				<b>Accommodates</b>	<b>Fights</b>
<b>The SME's Strategic Target &amp; Degree of Product Substitutability</b>					
				<b>The SME</b>	<b>New Market Segments Ignored by Bigger Firm</b>
<b>Established Market Served by Bigger Firm</b>	<b>Substitutable</b>	[2] Substitution Strategy	[4] Deterrence Strategy		
	<b>Identical</b>	[3] Free-Riding Strategy			

SMEs could also enter and capture a slice of the incumbent's market share by supplying a product identical to that of the incumbent's and undercutting its price to encourage consumer switching. This is the free-riding strategy. Establishing market presence through parallel imports and producing and marketing "me-too" products are examples of the free-riding strategy. By adopting such a strategy, SMEs are able to enter established markets without having to incur market development expenses. This makes sense as SMEs often lack the resources to undertake huge market developmental efforts. Instead, they are better off by

exploiting such efforts that are already undertaken by bigger incumbent firms, and hence, avoid incurring huge market development expenses. Thus, it is only when markets are ripe for the picking, that SMEs enter such markets with “me-too” products at lower prices to gain a share of the developed markets.

On the other hand, if it is anticipated that a bigger firm is aggressive in that it will “act crazy” by choosing to compete aggressively despite the high costs of doing so, then SMEs should pre-empt such aggression by adopting a strategic deterrence strategy. In following the deterrence strategy, it is important that SMEs credibly signal to aggressive incumbent firms their commitment to stay in the market. This commitment can be credibly conveyed by SMEs via the formation of strategic alliances and/or through strategic moves in committing themselves to investment in market development.

### **Competing for Markets: Growth Strategies for SMEs**

These strategies are discussed in depth in a new book *Competing for Markets: Growth Strategies for SMEs* (Singapore: McGraw Hill, 2002) by Lee Khai Sheang, Lim Guan Hua, and Tan Soo Jiuan. In it, the authors provide a set of prescriptive strategy tools for firms that are faced with resource disadvantages. Five chapters describe these growth strategies for SMEs in detail. To facilitate learning, each chapter contains Asian case illustrations, detailed analyses of these cases, and lessons learned from these analyses.